

Lewis R. Landau (SBN 143391)
Attorney-at-Law
22287 Mulholland Hwy., # 318
Calabasas, California 91302
Voice & Fax: (888)822-4340
Email: *lew@landaunet.com*

Attorneys for Debtor and Plaintiff

Daren R. Brinkman (CA Bar No. 158698)
Laura J. Portillo (CA Bar No.186813)
Kevin C. Ronk (CA Bar No. 241598)
4333 Park Terrace Dr., Ste 205
Westlake Village, CA 91361
Phone: (818) 597-2992
Fax: (818) 597-2998
Email: *firm@brinkmanlaw.com*

Attorneys for Official Committee of
Creditors Holding Unsecured Claims and Plaintiff

UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA
LOS ANGELES DIVISION

In re
Point.360, a California corporation,
Debtor.

Point.360, a California corporation, and the
Committee of Creditors Holding Unsecured
Claims,
Plaintiffs,

vs.

Medley Capital Corporation, a Delaware
corporation, Medley Opportunity Fund II,
LP, a Delaware limited partnership,
Defendants.

Case No.: 2:17-bk-22432-WB
Adv. No.: To be assigned

Chapter 11

COMPLAINT FOR:

- 1. MANDATORY SUBORDINATION AND CLAIM DISALLOWANCE;**
- 2. RECHARACTERIZATION AND CLAIM DISALLOWANCE;**
- 3. OBJECTION TO CLAIM; AND**
- 4. LIEN AVOIDANCE**
[11 U.S.C. §§ 502(b)(1); 510(b); 506(d)]

Date: To Be Set
Time: To Be Set
Place: Courtroom 1375; Judge Brand
US Bankruptcy Court
255 E. Temple Street, 13th Floor
Los Angeles, CA 90012

1 Plaintiff, Point.360, debtor-in-possession in the above-captioned bankruptcy case and as
2 plaintiff in the above-captioned adversary proceeding (“Point.360” or “Debtor”) and the
3 Committee of Creditors Holding Unsecured Claims (“Committee”) (Debtor and Committee
4 individually a “Plaintiff” and collectively “Plaintiffs”) hereby complain against Defendants,
5 Medley Capital Corporation (“MCC”) and Medley Opportunity Fund II, LP (“MOF II”)
6 (collectively MCC and MOF II are referred to herein as “Medley” or “Defendants”), as follows:

7 **STATEMENT OF JURISDICTION, PARTIES AND PROCEEDINGS**

8 1. This Court has jurisdiction over this proceeding pursuant to 28 U.S.C. §§ 157(b)(1)
9 and 1334(a), as this is a core proceeding under 28 U.S.C. § 157(b)(2)(A), (B), (C), (K) and (O).
10 Venue properly lies in this judicial district pursuant to 28 U.S.C. § 1409(a), in that the instant
11 proceeding is related to a case under title 11 of the United States Code which is still pending.

12 2. Debtor and Committee consent to entry of a final judgment by the Bankruptcy
13 Court.

14 3. This is an adversary proceeding under Federal Rules of Bankruptcy Procedure
15 3007(b) and 7001(2), (8).

16 **PARTIES**

17 4. Plaintiff, Point.360, is a corporation organized and existing under the laws of the
18 State of California, with its principal place of business at 2701 Media Center Drive, Los Angeles,
19 California. At all relevant times, Point.360 has been engaged in integrated media management
20 services, including archival, closed captioning and subtitling, editing, encoding and transcoding,
21 mastering, restoration, scanning, vaulting and worldwide physical and digital distribution of
22 television programming, feature films and movie trailers.

23 5. On October 10, 2017, the Debtor filed a voluntary petition for relief under Chapter
24 11 of the Bankruptcy Code. The Debtor continues in possession of its property and manages its
25 business as a debtor in possession pursuant to §§ 1107 and 1108 of the Bankruptcy Code.

26 6. The Committee was duly appointed by the Office of the United States Trustee on
27 March 22, 2018.

28

1 7. Defendant, MCC, is a corporation organized and existing under the laws of the
2 State of Delaware, with its principal place of business at 280 Park Avenue, 6th Floor East, New
3 York, New York.

4 8. Defendant, MOF, II is a limited partnership organized and existing under the laws
5 of the State of Delaware, with its principal place of business at 280 Park Avenue, 6th Floor East,
6 New York, New York.

7 9. On January 30, 2018, MCC and MOF II filed Claim Nos. 72 and 73 respectively in
8 Debtor's chapter 11 case. MCC and MOF II amended Claim Nos. 72 and 73 on November 7,
9 2018. True and correct copies of Claim Nos. 72 and 73 with the subsequent amendments are
10 attached as Request for Judicial Notice ("RFJN") Exhibits 1 and 2 filed concurrently herewith and
11 are incorporated herein by reference ("Claim Nos. 72 and 73").

12 **FACTUAL BACKGROUND**

13 10. At all relevant times, Modern VideoFilm, Inc. ("MVF") was a Burbank, California
14 based provider of post-production and distribution services to the film, television and media
15 content industries.

16 11. In September 2012, Medley made a fifty-million-dollar loan to MVF. The subject
17 loan replaced a then outstanding debt of \$80,651,000 owed by MVF, and resulted in the
18 forgiveness of \$30,651,000, which MVF recorded as a gain in other income on MVF's statement
19 of operations for the 2013 fiscal year.

20 12. Medley's loan to MVF bore interest at a combined 9% cash interest rate and 3%
21 PIK rate, plus an applicable margin of the greater of 1.5% and LIBOR, maturing on September 25,
22 2017. As of May 31, 2015, MVF owed Medley \$73,772,000 in unpaid loans, interest and fees,
23 and faced future lease obligations of \$36,567,000 through 2023.

24 13. Based upon MVF's alleged defaults, in July 2014, Medley took direct control of
25 MVF, and appointed representatives of Deloitte Corporate Finance, LLC ("DCF") and Deloitte
26 Transactions and Business Analytics, LLP ("DTBA")(collectively DCF and DTBA are referred to
27
28

1 herein as “Deloitte”) as Medley’s agents to assume the day-to-day operation of MVF.
2 Specifically, Medley appointed Deloitte employees Scott Avila (“Avila”) as MVF’s Chief
3 Restructuring Officer with the powers, duties and title of “CEO,” and Cooper Crouse (“Crouse”)
4 as Assistant Chief Restructuring Officer with the title of “President.”
5

6 14. In December 2014, Kevin McFarlane (“McFarlane”), Managing Director of DCF,
7 introduced the Debtor to an opportunity to merge with MVF, representing that using Debtor’s
8 stock might be a way for both MVF and Debtor to expand their business and create a return for
9 both Medley and Debtor.

10 15. For its part, Debtor was already experiencing its own financial challenges. Debtor
11 had suffered pre-tax losses of \$1.2 million in 2013, and \$2.7 million in 2014, based upon
12 substantially lesser sales than MVF. In December 2014, Debtor’s existing lender cancelled the
13 availability of funds under Debtor’s revolving credit facility due to the Debtor’s failure to meet its
14 financial covenants. Additionally, due to the Debtor’s failure to meet financial covenants in the
15 past, and uncertainty regarding the Debtor’s ability to meet new covenant requirements, Debtor
16 was required to classify the balance owed for its mortgage debt and capital leases as a current
17 liability in its consolidated balance sheet as of December 31, 2014, and in its Form 10-Q for the
18 quarterly period ended December 31, 2014.
19

20 16. Upon information and belief, prior to approaching Debtors, Defendants and
21 Deloitte had been unsuccessfully marketing MVF to other potential purchasers, as evidenced by
22 the creation of a data room of historical and current MVF data and financial information which
23 Debtor was given access to on March 4, 2015.
24

25 17. Defendants apparently determined that their only viable path forward was to
26 accommodate MVF’s *de facto* sale as a going concern to Debtor, with the hope that the economies
27 of scale achievable by the merger of MVF and Debtor would permit Defendants to: (1) report that
28

1 they had avoided the total loss of their investment in MVF, (2) avoid the prospect of incurring the
2 foregoing wind-up costs, and (3) at least potentially obtain a return on its loans to/investment in
3 MVF by acquiring a substantial equity stake in Debtor.

4 18. On or about March 19, 2015, McFarlane provided Debtor with an initial term sheet,
5 which contemplated: (1) the sale of MVF's assets in return for Debtor's payment of cash and grant
6 of Debtor's stock to Medley, and (2) positions on Debtor's board of directors held by board
7 members designated by Defendants. No extension of credit by Medley to Debtor was mentioned
8 in the initial term sheet.
9

10 19. On or about March 23, 2015, a telephonic meeting between Debtor's
11 representatives, Avila and McFarlane was held to discuss the initial term sheet. At this and
12 ensuing meetings, Avila and Crouse emphasized their experience in the industry, citing their
13 previous experience working together for Deloitte at Culver Studios, in Culver City, California.
14

15 20. On or about March 26, 2015, a face-to-face meeting between Debtor's
16 representatives and various representatives of Medley and Deloitte took place at Deloitte's Los
17 Angeles office.

18 21. On April 2, 2015, Medley and Deloitte provided the Debtor with a consolidation
19 model based upon a merger with the Debtor which reflected that MVF's revenue would drop from
20 \$44 million to \$29 million, but, based upon economies of scale, MVF's operating income and
21 EBITDA would increase to \$3.6 million and \$4.1 million respectively.
22

23 22. On or about April 29, 2015, a face-to-face meeting between Debtor's
24 representatives, and representatives of Medley and Deloitte took place at Medley's office in New
25 York. The agenda for the meeting prepared by Medley included discussion of: (1) "integration
26 costs as well as the bearer of these costs"; (2) a "[p]lan to finance working capital needs for
27
28

1 integration and growth”; and (3) an “[e]quity split.” During the meeting, Defendants and their
2 agents again described the proposed transaction as an “equity play.”

3 23. On May 14, 2015, Debtor’s CFO, Alan Steel, wrote to Avila raising a number of
4 significant issues. Among the issues Steel raised was the fact that the Debtor “contemplate[d] that
5 the MVF [merger would] generate at least \$3 to \$4 million of negative cash flow” by the end of
6 2015. Avila responded, in part, that the “funding [Medley] is providing is intend[ed] to finance
7 the transition.”
8

9 24. Additionally, Steel expressed concern that “overburdening the combined entity
10 with too much debt and not enough equity ... will impair value creation.” Avila responded that “I
11 completely understand. So I recommend we address this in the due diligence process through the
12 financial projections....”
13

14 25. Finally, Steel stated that Debtor needed “to see an updated first 12-month sales and
15 cash flow forecast considering the possible effects of the announced Warner Bros./Deluxe
16 deal,” as Defendants and their agents had previously identified Warner Brothers as MVF’s largest
17 customer. Avila responded:

18 I completely understand the fear that you and your team have regarding a deal of
19 this magnitude in light of all the issues at Point360 and MVF. I am sure you can
20 understand *Medley’s prospective [sic] (a) a minority investment, (b) cash*
21 *investment in addition to asset contribution*. One thing I can say is that if we do
22 this Point360 gets a strong, stable and sophisticated capital partner which has the
demonstrated record of supporting its management teams and companies – this is
clearly something you don’t have today.

23 (*Emphasis added*).

24 26. On May 20, 2015, the parties entered into a signed term sheet which called for
25 Medley to receive 37% of the common stock of Point.360, to have two Medley representatives on
26 the Point.360 Board of Directors, and to make a \$5 million term loan to Point.360 “to fund capital
27 expenditures in connection with the build-out of [Point.360] to accommodate the transfer from
28

1 MVF's Burbank, Santa Monica and Glendale facilities ... and for working capital." The subject
2 term sheet also provided that Point.360 would "not issue any public announcement about the
3 Transaction without the approval of Medley...."

4 27. On July 8, 2015, Debtor and Medley contemporaneously executed and closed on
5 the "Sale Agreement Pursuant to Article 9 of the Uniform Commercial Code" ("the Sale
6 Agreement") and the closely related "Term Loan Agreement" ("TLA") and Security Agreement.
7

8 28. Throughout their negotiations, Debtor and Medley treated the Sale Agreement,
9 TLA and Security Agreement as a single transaction and agreement ("the Transaction"). The
10 parties conducted all the negotiations relating to the Sale Agreement, TLA and Security
11 Agreement based upon that understanding.

12 29. The Bankruptcy Court determined that the Sale Agreement, TLA and Security
13 Agreement are integrated contracts in connection with granting summary judgment in adversary
14 proceeding 2:18-ap-01435 WB per order entered March 11, 2019.
15

16 30. Pursuant to the Sale Agreement, ***Debtor paid no cash to Medley. Rather, Medley***
17 ***obtained 2,000,000 shares and 800,000 warrants in Debtor.*** (Sale Agreement at § 1.3).

18 31. Pursuant to the Sale Agreement, Debtor granted Medley two (2) seats on Debtor's
19 expanded seven person board (initially Feeley and fellow Medley Senior Managing Director and
20 Head of Tactical Opportunities, James D. Frank). (Sale Agreement at § 4.2(a)).
21

22 32. Additionally, pursuant to the Sale Agreement, Debtor agreed to make employment
23 offers to *all* existing employees of MVF in substantially similar roles and with the same annual
24 salary, and to pay certain PTO, sparing Defendants potential state and federal WARN Act liability.
25 (Sale Agreement at §§ 1.2 and 4.8).
26
27
28

1 33. As a result of closing on the transaction, Debtor's bi-weekly employee payroll
2 increased from \$485,532 (\$12,623.832 annually) to \$1,276,272 (\$33,183.072 annually), a nearly
3 three-fold increase.

4 34. Finally, the Sale Agreement provided that, upon the closing of the Sales
5 Agreement, Medley was obligated to provide Point.360 with a \$6 million five year term loan.
6 (Sale Agreement at § 4.10).
7

8 35. The Sale Agreement is expressly governed by California law.

9 36. Contemporaneously, the Debtor and Medley entered into the TLA and Security
10 Agreement. The TLA was expressly conditioned upon the closing of the Sale Agreement. (TLA
11 at §§ 1.(a) and 5(c).
12

13 37. The final paragraph of Section 1(a) of the TLA expressly provided:

14 **In consideration for the Term Loans**, the [Debtor] shall issue to [Medley] five
15 year warrants (the "*Warrant*") ... to purchase an aggregate 500,000 shares (the
16 "*Warrant Shares*") of common stock of the [Debtor]....

17 **(Bold added)(italics in original).**

18 38. The TLA further recited that the loan proceeds:

19 [S]hall be used solely (i) to refinance certain indebtedness of the Borrower, (ii) to
20 pay the transaction fees, costs and expense incurred directly in connect with the
21 transaction contemplated hereby, (iii) for capital expenditures in connection with
22 the build-out and integration of the Borrower's business following the acquisition
23 of substantially all of the asset of [MVF], and (iv) for working capital and general
24 corporate purposes of the Borrower.

25 39. Pursuant to the TLA, Debtor was not required to make any payments to Medley
26 until the end of the five year term. Section 2 of the TLA provided that interest, at the election of
27 the Debtor, could be capitalized and added to the principal amount due at the end of the term.

28 40. Section 3 of the TLA called for interest to be paid of 6.0% plus the three month
LIBOR rate published in the WSJ.

1 41. At the time the Debtor entered into the Sale Agreement, TLA and Security
2 Agreement, Debtor could not have obtained a similar arms-length loan from an independent
3 lender.

4 42. Shortly after the closing, on August 12, 2015, Medley hosted a quarterly-earnings
5 call with analysts. When Medley's Chairman and CEO, Brook Taube ("Taube") was asked
6 about any lessons Medley had learned from underwriting the toxic MVF loan, Taube pivoted to a
7 description of the MVF-Point.360 merger. After describing the combined company as a "very
8 strong number two player" in the marketplace, he added: "[o]ur assessment was this was the best
9 opportunity to maximize the value [of the MVF loss/investment] over time." Taube added "our
10 team is going to be focused extremely hard on supporting this business and getting back as much
11 of our initial[] investment [in MVF] as we possibly can."

12 43. As of the closing date of the MVF transaction on July 9, 2015, Debtor's total
13 unsecured debt (excluding its capital leases, term loans and line of credit – which were secured by
14 Debtor's fixed assets and/or accounts receivable -- and including accrued vacation for Debtor's
15 employees) was less than \$745,000. On the date Debtor filed its voluntary petition for relief under
16 Chapter 11 of the Bankruptcy Code, that figure had increased nearly six-fold to \$4,235,547.

17 44. During its 2015 fiscal year ending June 30, 2015, Debtor sustained an operating
18 loss of \$2.95 million, the same operating loss it had sustained for the 2014 fiscal year. After the
19 July 8, 2015 Transaction, Debtor suffered operating losses in excess of \$8.9 million during the
20 2016 fiscal year and \$9.9 million in 2017, owing primarily to massive increases in the cost of
21 services sold and selling, general and administrative expenses.

22 45. On March 31, 2016, less than nine months after the closing on the Sale Agreement,
23 TLA and Security Agreement, the Medley designees on the Debtor's Board of Directors resigned.

FIRST CLAIM FOR RELIEF

**(Mandatory Subordination Pursuant To 11 U.S.C. § 510(b) and
Disallowance under 11 U.S.C. § 502(b)(1))**

46. Plaintiffs reallege and incorporate herein by reference each and every allegation contained in paragraphs 1 through 45 as though set forth in full.

47. Section 510(b) of the Bankruptcy Code requires that a claim arising from the purchase or sale of a security of a debtor must be subordinated to all claims that are senior to or that equal the holder of that claim. If, as here, the security is common stock, the holder of the claim has the same priority as current holders of common stock.

48. Section 1 of the TLA attached as Exhibit 1 to the MCC and MOF II Claim Nos. 72 and 73 (“Term Loan Agreement”) recites that the Debtor’s issuance of equity securities to MCC and MOF II constitutes consideration for the Term Loans:

In consideration for the Term Loans, the Borrower shall issue to the Lender five-year warrants (the “Warrant”), substantially in the form attached hereto as Exhibit C, to purchase an aggregate 500,000 shares (the “Warrant Shares”) of common stock of the Borrower, at an exercise price of \$0.75 per share.

49. Pursuant to Section 24 of the TLA, the Term Loans and Warrants are deemed to be the Debtor’s issuance of an “investment unit” under the Internal Revenue Code.

50. Under Ninth Circuit law, “[i]f the promissory note claims are linked to the [issuance of securities], they should be subordinated.” In re Betacom of Phx., Inc., 240 F.3d 823, 831-832 (9th Cir. 2001).

51. Medley’s Term Loan Agreement and promissory note claims are *expressly linked* to the issuance of securities as the recited consideration for the Term Loan Agreement.

52. The economic reality of the Transaction further evidences the close nexus between the purported “loan” and the purchase of Debtor’s securities in return for Medley’s contribution of MVF’s assets.

53. Debtor lacked the working capital and/or credit to purchase MVF’s assets and offer employment to MVF’s nearly three hundred employees pursuant to § 4.8 of the Sale Agreement,

1 and lacked the creditworthiness to obtain arms-length financing for the Transaction from any other
2 source.

3 54. Defendants were fully aware that, without their extension of purported “credit” on
4 materially better terms than the Debtor could have obtained from any other informed lender, the
5 Transaction could not, and would not, have occurred.

6 55. Defendants entered into the TLA as a part of the Transaction with the expectation,
7 and for the sole purpose, of acquiring the Debtor’s securities and potentially enhancing the value
8 of the substantial equity interest in the Debtor which Defendants were obtaining in the
9 Transaction.

10 56. Defendants would not have entered into the Transaction and/or the TLC, but for the
11 Debtor’s issuance of a combined 2,000,000 shares of Debtor’s common stock and 1,300,000
12 warrants to purchase Debtor’s common stock and such equity securities were the primary return
13 expectation for Medley.

14 57. MCC and MOF II Claim Nos. 72 and 73 are claims for damages arising from the
15 purchase or sale of an equity security consisting of warrants for common stock of the Debtor.

16 58. Pursuant to 11 U.S.C. § 510(b), MCC and MOF II Claim Nos. 72 and 73 are
17 subject to mandatory subordination and shall be treated with the same priority as common stock.

18 59. MCC and MOF II Claim Nos. 72 and 73 are unenforceable against the Debtor or
19 property of the Debtor and are subject to disallowance under 11 U.S.C. § 502(b)(1).

20 **SECOND CLAIM FOR RELIEF**

21 **(Recharacterization and Disallowance under 11 U.S.C. § 502(b)(1))**

22 60. Plaintiffs reallege and incorporate herein by reference each and every allegation
23 contained in paragraphs 1 through 59 as though set forth in full.

24 61. MCC and MOF II allege claims for debt in Claim Nos. 72 and 73 consisting of
25 Term Loans granted under Medley’s TLA.

26 62. The economic reality of the MCC and MOF II Claim Nos. 72 and 73 is that the
27 Medley Term Loans are in economic substance an equity contribution rather than a true debt
28 obligation.

1 63. Debtor lacked sufficient capital to move forward with the Transaction.

2 64. Debtor lacked sufficient capital to obtain a loan on terms equivalent to those
3 provided for in the TLA from an informed outside lender.

4 65. The amount of the “term loan” provided coincided with the anticipated capital
5 required to fund PTO related to the MVF employees hired by the Debtor, to pay for rent for the
6 post-closing period necessary to complete the move of MVF’s equipment to the Debtor, and for
7 the anticipated first year negative cash flow during the transition from two separate companies to a
8 single consolidated operation.

9 66. The Term Loans in MCC and MOF II Claims Nos. 72 and 73 did not require
10 payments for a five-year term.

11 67. When granting the Term Loans, Medley became both a purported creditor and
12 equity security holder.

13 68. Medley obtained two (2) seats on Debtor’s board of directors.

14 69. Although Medley obtained collateral for the alleged Term Loans, Medley
15 authorized senior mortgage borrowings up to \$5 million and senior credit facilities of \$7 million.

16 70. The Medley Term Loans were subordinate to the claims of certain outside
17 creditors.

18 71. The Medley advances were not used to acquire capital assets but were instead used
19 to sustain operations.

20 72. Debtor had no sinking fund to provide for repayments.

21 73. The Court should find and determine that Medley’s Term Loans constitute equity
22 capital contributions to the Debtor, do not constitute *bona fide* indebtedness and are unenforceable
23 against the Debtor or property of the Debtor pursuant to 11 U.S.C. § 502(b)(1).

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THIRD CLAIM FOR RELIEF

(Objections to Claims under 11 U.S.C. § 502(b)(1); FRBP 3007(b))

74. Plaintiffs reallege and incorporate herein by reference each and every allegation contained in paragraphs 1 through 73 as though set forth in full.

75. Pursuant to 11 U.S.C. § 502(b)(1), “[e]xcept as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that — (1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured.”

76. Based on the claims set forth hereinabove, MCC and MOF II Claim Nos. 72 and 73 are unenforceable against the debtor and property of the debtor under applicable law.

77. Plaintiffs request entry of a judgment disallowing MCC and MOF II Claims Nos. 72 and 73.

FOURTH CLAIM FOR RELIEF

(Lien Avoidance under 11 U.S.C. § 506(d))

78. Plaintiffs reallege and incorporate herein by reference each and every allegation contained in paragraphs 1 through 77 as though set forth in full.

79. Pursuant to 11 U.S.C. § 506(d), “to the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void.”

80. To the extent the MCC and MOF II Claims Nos. 72 and 73 are disallowed under 11 U.S.C. § 502(b)(1), any Medley lien securing such claim is void.

81. Plaintiffs request entry of a judgment voiding Medley’s liens upon disallowance of MCC and MOF II Claims Nos. 72 and 73.

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1 **WHEREFORE**, Plaintiffs pray for judgment as follows:

2 1. Entry of a judgment for mandatory subordination under 11 U.S.C. § 510(b) and
3 disallowance of MCC and MOF II Claim Nos. 72 and 73 under 11 U.S.C. § 502(b)(1).

4 2. Entry of a judgment recharacterizing MCC and MOF II Claim Nos. 72 and 73 as a
5 capital contribution equity interest in the Debtor and disallowing Claims Nos. 72 and 73 under 11
6 U.S.C. § 502(b)(1).

7 3. Entry of a judgment disallowing MCC and MOF II Claims Nos. 72 and 73 under
8 11 U.S.C. § 502(b)(1).

9 4. Entry of a judgment voiding Medley's liens under 11 U.S.C. § 506(d) upon
10 disallowance of MCC and MOF II Claims Nos. 72 and 73 under 11 U.S.C. § 502(b)(1).

11 5. For attorney's fees and costs pursuant to contract.

12 6. For such other and further relief as the Court deems just and proper.

13 Dated: May 1, 2019

Lewis R. Landau
Attorney at Law

By: /s/ Lewis R. Landau
Lewis R. Landau
Attorney for Debtor

17 Dated: May 1, 2019

Brinkman Portillo Ronk APC

By: /s/ Daren R. Brinkman
Daren R. Brinkman
Attorneys for the Committee